

The impact of FRS102 on credit unions using Curtains Too the SQL

Contrary to popular belief, FRS102 is not simply the registration mark of the old Mk2 Cortina that lies in the car park behind our offices in Paisley Road West, its also the new accounting standards that UK credit unions are required to follow in financial years that begin during 2015 and beyond.

Despite this important development, typing FRS102 into the search box of the PRA website is met with the statement 'We did not find any results for **FRS102**' and suggests that we should 'Ensure words are spelled correctly etc., etc., While a similar search of the FCA website shows no results and suggests that we 'Search instead for **FRS102**', as if bold and italic is going to make a material difference.

This leaves us with 'Staff Education Note 14, Credit unions - Illustrative financial statements' from the Financial Reporting Council (FRC), first published in 2009 as the main definitive guide to determining compliance with the instruments.

Reference to GABRIEL (the direct submissions gateway, not the Angel referred to in the Gospel according to St Luke) reveals a similar Balance sheet style to that illustrated in the aforementioned FRC publication.

Page 10 in that publication <https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/SEN-14-Illustrative-Credit-Union-Financial-Stateme.pdf> shows a sample Balance sheet¹ (aka. Statement of financial position) that appears to be turned upside down and, if your Board is not completely comfortable with the traditional style, best of luck with this one (see Fig I below).

Balance Sheet⁷			
as at 30 September 2016			
	Note	2016 £	2015 £
ASSETS			
Cash, cash equivalents and liquid deposits ⁸			
Cash and balances with the Bank of England ⁹	15	-	-
Loans and advances to banks	15	<u>1,542,720</u>	<u>2,148,704</u>
Loans and advances to members	11	13,713,454	12,243,266
Tangible fixed assets	10	100,818	114,615
Other receivables		23,374	22,725
Prepayments and accrued income		<u>22,315</u>	<u>28,878</u>
Total assets		<u>15,402,681</u>	<u>14,558,188</u>
LIABILITIES			
Subscribed capital – repayable on demand	12	(13,655,585)	(13,004,895)
Other payables	13	<u>(39,538)</u>	<u>(46,843)</u>
		<u>(13,695,123)</u>	<u>(13,051,738)</u>
Retained earnings		<u>1,707,558</u>	<u>1,506,450</u>
Total liabilities		<u>15,402,681</u>	<u>14,558,188</u>

Fig I - Balance sheet (ignore the numbers in superscript)

¹ Balance sheet is the term used in the Friendly and Industrial and Provident Societies Act 1968. FRS102 does not require Credit unions to use the title 'Statement of financial position'

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Changes to the Revenue account (aka. Profit and loss account, Income and expenditure account, Income statement² etc.) are less significant and relate primarily to the positioning of Fees and commissions payable (primarily bank charges, but could include commissions paid to financial advisors in respect of advice in provision of mortgage loans etc.), and the introduction of the word 'Impairment'

Revenue Account¹			
for the year ended 30 September 2016			
	Note	2016 £	2015 £
Loan interest receivable and similar income	4	1,019,175	945,434
Interest payable	5	(318,670)	(435,007)
Net interest income²		700,505	510,427
Fees and commissions receivable	6	3,532	3,184
Fees and commissions payable ³		(3,179)	(3,110)
Net fees and commissions receivable⁴		353	74
Other income		893	5,008
Administrative expenses	7a	(304,401)	(333,317)
Depreciation and amortisation	10	(22,214)	(24,230)
Other operating expenses	7b	(104,419)	(115,420)
Impairment losses on loans to members ⁵	11e	(58,585)	(52,433)
Surplus before taxation		212,132	(9,891)
Taxation	9a	(11,024)	(26,950)
Surplus for the financial year		201,108	(36,841)
Other comprehensive income ⁶		-	-
Total comprehensive income		201,108	(36,841)

Fig II - Revenue account (ignore the numbers in superscript)

There is little need to describe 'Interest payable' except as before to recognise its new position on the Revenue account.

That leaves us with 'Impairment', which seems synonymous with 'Provisions'. Impairment, and provisions are inseparably integrated into broader frameworks that describe the recognition and valuation of the items in the Balance sheets and Revenue accounts of credit unions.

Loan impairment is an inherent risk in a credit union. Since credit unions often lend in a fairly risky environment there is a calculated probability that some of the loans will not be collected in full. A loan is impaired when, based on current information and events, it is probable that the credit union will be unable to collect all amounts due according to the contractual terms³ of the loan agreement.

Rules associated with impairment are described in some detail in chapter 11 of the FRC publication of March 2013 entitled 'The Financial Reporting Standard applicable in the UK and Republic of Ireland.

² Revenue account is the term used in the Friendly and Industrial and Provident Societies Act 1968. FRS102 does not require Credit unions to use the title 'Income statement'

³ In the case of a re-scheduled loan, the 'contractual terms' relate to those of the original loan.

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This can be found at <https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-102-The-Financial-Reporting-Standard-applicabl.aspx>

11.20 If an entity revises its estimates of payments or receipts, the entity shall adjust the carrying amount of the financial asset or financial liability (or group of financial instruments) to reflect actual and revised estimated cash flows. The entity shall recalculate the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate. The entity shall recognise the adjustment as income or expense in profit or loss at the date of the revision.

Recognition

11.21 At the end of each reporting period, an entity shall assess whether there is objective evidence of impairment of any financial assets that are measured at cost or amortised cost. If there is objective evidence of impairment, the entity shall recognise an impairment loss in profit or loss immediately.

11.22 Objective evidence that a financial asset or group of assets is impaired includes observable data that come to the attention of the holder of the asset about the following loss events:

- (a) significant financial difficulty of the issuer or obligor;
- (b) a breach of contract, such as a default or delinquency in interest or principal payments;
- (c) the creditor, for economic or legal reasons relating to the debtor's financial difficulty, granting to the debtor a concession that the creditor would not otherwise consider;
- (d) it has become probable that the debtor will enter bankruptcy or other financial reorganisation; and
- (e) observable data indicating that there has been a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, even though the decrease cannot yet be identified with the individual financial assets in the group, such as adverse national or local economic conditions or adverse changes in industry conditions.

11.23 Other factors may also be evidence of impairment, including significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates.

11.24 An entity shall assess the following financial assets individually for impairment: (a) all equity instruments regardless of significance; and (b) other financial assets that are individually significant. An entity shall assess other financial assets for impairment either individually or grouped on the basis of similar credit risk characteristics.

Nevertheless, impairment cannot exceed the value of the asset (in credit union, 'the loan'). In general, measuring loan impairment requires judgment and estimates, and the eventual outcomes may differ from those estimates. Creditors typically have latitude to develop measurement methods that are practical in their circumstances.

The most common method of measuring impairment is to calculate the difference between the present value of expected future cash flows discounted at the loan's effective interest rate⁴ and the recorded investment⁵ in the loan. Therefore it may even be necessary to adjust impairment in circumstances

⁴ The effective interest rate of a loan is the rate of return implicit in the loan (in credit union that is, the original contractual interest rate).

⁵ Recorded investment in the loan includes accrued interest

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where the interest rate on a loan is reduced on, for example, passionate grounds or more importantly if the member is unable to fulfil his/her commitment.

Statement of changes in retained earnings

FRS102 requires that the credit union prepares an additional document, known as 'Statement of changes in equity' which illustrates the movement in the credit union's reserves during the reported financial year.

The illustration in the FRC Staff education notes describes this as 'Statement of changes in retained earnings (see Fig III below

Statement of changes in retained earnings		
for the year ended 30 September 2016		
	2016	2015
	£	£
As at 1 October 2015	1,506,450	1,543,291
Total comprehensive income for the year	201,108	(36,841)
As at 30 September 2016	1,707,558	1,506,450

Fig III - Statement of changes in equity

Fortunately, as an esteemed Kesho client, help is at hand to ease your credit union through the transition. In mid-December we will publish an update that will include new 'Statutory accounts production' maintenance and reporting programs which will allow creation of the parameters that will produce this new report.

Nevertheless, what all of this means is that there is some work required by the credit union, reorganising its nominal coding plan to conform, in particular, with the new balance sheet format. However, again, Kesho is here to help and will supply a nominal renumbering kit that will take the majority of the pain out of the exercise.

Cash flow statement

The credit union may also wish to produce a 'Cash flow statement as illustrated in the FRC Staff education notes. This can be easily configured and produced using the new programs described above, and once configured can be produced automatically. See fig IV below.

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Cash flow statement¹¹			
for the year ended 30 September 2016			
	Note	2016 £	2015 £
Cash flows from operating activities			
Surplus/(deficit) before taxation		212,132	(9,891)
Adjustments for non-cash items:			
Depreciation	10	22,214	24,230
Impairment losses	11e	59,746	56,536
		<u>81,960</u>	<u>80,766</u>
Movements in:			
Accrued interest		6,563	44,024
Other receivables		(649)	(3,453)
Other payables		8,618	3,230
		<u>14,532</u>	<u>43,801</u>
Cash flows from changes in operating assets and liabilities			
Cash inflow from subscribed capital	12	5,272,934	5,019,614
Cash outflow from repaid capital	12	(4,622,244)	(5,035,601)
New loans to members	11a	(7,713,518)	(6,887,274)
Repayment of loans by members	11a	6,183,584	6,269,395
		<u>(879,244)</u>	<u>(633,866)</u>
Taxation paid		(26,947)	(37,893)
Net cash flows from operating activities		<u>(597,567)</u>	<u>(557,083)</u>
Cash flows from investing activities			
Purchase of property, plant and equipment	10	(8,417)	(10,327)
Net cash flow from managing liquid deposits		250,000	(1,000,000)
		<u>241,583</u>	<u>(1,010,327)</u>
Net decrease in cash and cash equivalents		<u>(355,984)</u>	<u>(1,567,410)</u>
Cash and cash equivalents at beginning of year		1,148,704	2,715,844
Cash and cash equivalents at end of year	15	<u>792,720</u>	<u>1,148,704</u>

Fig IV – Cash flow statement

Other items worth considering

Although most credit unions rely on their external Auditor to produce the financial statements at the end of each accounting year, best practice suggests that the Board and/or senior management should provide the substance for notes to the accounts. Listed below are a number of items that will require, at the very least, analysis to be easily extractable.

- a) Accrued holiday pay
- b) Acquisition accounting
- c) Calculation and judgment techniques
- d) Disclosure of staff and directors' savings and loan balances
- e) Management remuneration (including amounts paid to directors)
- f) Security held in respect of loans

References

Illustrations and other extracts are taken from FRC publications as noted within.